

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2003-00488 DATED DECEMBER 24, 2003.

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A REVIEW OF THE RATES OF ELAM UTILITY)	
COMPANY, INC. PURSUANT TO THE DECISION)	CASE NO.
TO APPROVE THE FINANCING REQUESTED)	2003-00171
IN CASE NO. 2001-00324)	

O R D E R

On May 28, 2003, the Commission initiated on its own motion a review of the rates of Elam Utility Company, Inc. ("Elam") pursuant to the decision to approve financing requested by Elam in Case No. 2001-00324.¹ On July 17, 2003, Commission Staff conducted a limited financial review of Elam's operations for the year ended December 31, 2002. Based upon this review Staff issued its report on September 17, 2003, recommending a reduction of \$18,033.37 in annual revenues, which is a 2.92 percent decrease from Staff-adjusted normalized revenues.

By Order entered September 17, 2003, the Commission directed Elam to file comments on the Staff Report, or to request a hearing or informal conference within 10 days of the date of the Order. No response has been received from Elam and therefore the case stands submitted for decision.

¹ Case No. 2001-00324, Application of Elam Utility Company, Inc., Morgan & Wolfe County, Kentucky, for the Authority to Borrow \$797,425 from the Economic Development Administration Through the Department for Local Government, final Order issued December 3, 2001.

STAFF REPORT ISSUES

Accounting and Record-Keeping Issues

In Case No. 2000-00432,² Elam's last general rate case, the Commission adopted all the recommendations and findings contained in the March 14, 2001 Staff Report as its findings in that proceeding. Included in the recommendations were 12 accounting and record-keeping recommendations, which Elam accepted. However, during a subsequent follow-up review conducted by the Staff in March 2002, Elam had complied with only four of the recommendations. During the field review conducted in conjunction with this proceeding, Staff determined that while Elam had made progress on implementing the remaining recommendations, it still had not implemented all 12 recommendations.

The accounting and record-keeping recommendations were accepted by Elam and adopted by the Commission as a means to correct problems and improve Elam's financial operating procedures. The Commission views these recommendations to be as important now as when we approved them in March 2001. The Commission expects Elam to implement the remaining accounting and record-keeping recommendations, and will have its Staff conduct a second follow-up review at a later date to monitor Elam's implementation of the recommendations. The Staff will be available to assist Elam with the implementation upon its request for assistance.

² Case No. 2000-00432, The Application of Elam Utility Company, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities, final Order dated March 30, 2001.

Gas Cost Adjustment (“GCA”)

As noted in the September 17, 2003 Staff Report, Elam has not filed a quarterly GCA since March 2002. Elam’s tariff states that its GCA will be filed quarterly. The GCA of \$6.2084 per Mcf currently charged includes three gas bills totaling \$48,650.72 that were paid off using the proceeds from financing Elam secured through the Kentucky Department for Local Government (“DLG”). In Case No. 2001-00324, the Commission approved Elam’s request to borrow \$797,425.00 from the Economic Development Administration through DLG. The loan funds were used to pay off past due gas bills, past due operating expenditures, and refinance existing debt. The past due gas bills paid off by the DLG loan included the three bills reflected in the last GCA filed by Elam.

The Staff Report included the calculation of a new GCA for Elam of \$6.5249 per Mcf, which is to become effective with the change in base rates. The new GCA reflects the current gas cost information for Elam and refunds to ratepayers the \$48,650.72 that had been double recovered by Elam.

The Commission is concerned that Elam has not timely filed its GCA. The GCA mechanism is designed to generate revenues to cover gas supply costs. Failure to make the GCA filings on a timely basis could have serious impacts on Elam’s cash flow. The Commission finds that Elam should file its quarterly GCA on a timely basis. The Commission through its Staff is willing to provide Elam with any assistance it needs in preparing the GCA filings on a more timely basis.

The Commission will also monitor Elam’s compliance with this finding during the 6 months subsequent to the date of this Order. If Elam fails to make timely GCA filings

during that period, the Commission will consider initiating proceedings against Elam for its violation of the Commission's Order.

Interest on Customer Deposits

As noted in the September 17, 2003 Staff Report, Elam has not paid interest on its customer deposits during 2002. Pursuant to KRS 278.460 and 807 KAR 5:006, Section 7(6), Elam is required to pay interest at a rate of 6 percent annually on customer deposits. The Commission finds that Elam should immediately bring its practices concerning customer deposits into compliance with statute and regulations. The Commission further finds that Elam should pay accrued interest on customer deposits from the last interest payment date. The Commission's Staff will be available to assist Elam with the calculation of accrued interest.

Rate Design

The September 17, 2003 Staff Report recommended that Elam's rate structure for residential and commercial customers be changed from a two-step rate to a one-step rate. The Commission finds this recommendation reasonable and it should be approved.

Dividends

For calendar year 2002, Elam reported net income of \$145,744.28. During the field review, Staff discovered that Elam paid its owner dividends of \$39,000.00 during 2002 and \$40,000.00 during the first 6 months of 2003. The timing of the DLG loan, the increased revenues from Case No. 2000-00432, the failure to file timely GCAs, and the double recovery of past due gas bills through the GCA and DLG loan apparently provided sufficient cash flow for Elam to pay substantial dividends to its owner.

During the past few years Elam's financial condition has been unstable. Since 1999, it has secured two loans from DLG and received approval of a rate increase. In the December 3, 2001 Order in Case No. 2001-00324 the Commission identified the major reason Elam was in such a difficult financial condition. In 1993, the current owner acquired Elam through a stock purchase and this purchase was funded by a loan that the Commission expressly stated was the personal liability of the current owner. However, the loan was recorded as a liability on the books of Elam and the monthly loan payments were made from Elam's revenues. In the December 3, 2001 Order the Commission concluded that "the liability is improperly on the utility's books and the payment of principal and interest appears to be the prominent reason for Elam's cash flow problems."³

In the December 3, 2001 Order the Commission explicitly prohibited the use of Elam's funds to make the loan payments, which total \$42,173.16 annually.⁴ The conditions the Commission required in its approval of the pending DLG financing included the following requirements:

- Elam was prohibited from using any of the proceeds from the pending DLG financing to make any payments on the loan.
- The loan for the stock purchase had to be removed from Elam's books and appropriate accounting entries were to be made to reverse the effects of the loan and payments made on it.

As noted in the Staff Report in this proceeding, Elam removed the loan from its books by March 2002 and there was no evidence that Elam was making the loan payments

³ Case No. 2001-00324, December 3, 2001 Order at 2.

⁴ Id. The monthly loan payment of \$3,514.43 multiplied by 12 results in the annual payment of \$42,173.16.

from utility revenues. However, as noted previously, Elam's owner was paid dividends of \$39,000.00 in 2002 and \$40,000.00 has already been paid to the owner in 2003.

The declaration and payment of dividends in and of itself is not an inappropriate business activity. However, given Elam's past financial difficulties, the Commission has concerns about the appropriateness of paying such significant levels of dividends. Therefore, the Commission will monitor any future dividend declarations and payments by Elam to its owner. Upon declaring any future dividend, Elam will notify the Commission in writing that the dividend has been declared, submit a written cash flow analysis showing the impact of the declared dividend on the financial condition of Elam, and explain why the payment of the dividend is reasonable.

OTHER ISSUES

In its December 3, 2001 Order in Case No. 2001-00324, the Commission ordered Elam to file copies of its monthly general ledger and bank statements by the tenth day of every month.⁵ Elam has not remained in compliance with this requirement and has not sought Commission approval to be relieved of the responsibility. The Commission reminds Elam that this filing requirement is still in force. Elam should take the necessary steps to become current with these filings and should remain in compliance with the Case No. 2001-00324 Order.

SUMMARY

The Commission, after considering the evidence of record and being otherwise sufficiently advised, finds that:

⁵ Id. at 5.

1. The recommendations and findings contained in the September 17, 2003 Staff Report are supported by the evidence of record, are reasonable, and are hereby adopted as the findings of the Commission in this proceeding and are incorporated by reference as if fully set out herein.

2. The rates in the Appendix, attached hereto and incorporated herein, are the fair, just, and reasonable rates for Elam. These rates are the rates recommended in the September 17, 2003 Staff Report and include a GCA rate of \$6.5249. The GCA rate is also recommended in the September 17, 2003 Staff Report. They will allow Elam sufficient revenues to meet its operating expenses and provide for future equity growth, including provisions for servicing its debt.

IT IS THEREFORE ORDERED that:

1. The rates contained in the Appendix are approved for service rendered by Elam on and after November 1, 2003.

2. Within 30 days of the date of this Order, Elam shall file with the Commission its revised tariff setting out the rates approved herein.

3. Elam shall implement the remaining accounting and record-keeping recommendations that were adopted in Case No. 2000-00432. The Commission's Staff will perform a follow-up review to determine the extent of Elam's implementation at a later date.

4. In accordance with its tariff, Elam shall file its next GCA by December 1, 2003. Elam shall file all subsequent GCA filings in compliance with its filed tariff.

5. Elam shall modify its business practices to comply with the requirements of KRS 278.460 and 807 KAR 5:006, Section 7(6). Elam shall also pay all accrued

interest on its customer deposits from the last interest payment date by December 31, 2003 and submit written evidence to the Commission that it has paid the interest by January 10, 2004.

6. Elam shall file with the Commission by November 10, 2003 the general ledger and a copy of the bank statement for the month of October 2003. In addition, Elam shall file by November 30, 2003 all monthly general ledgers and copies of bank statements that it has not filed prior to the month of October 2003. For all months after October 2003, Elam shall file, by the tenth of every month, the monthly general ledger and a copy of the bank statement for the preceding month.

7. In the event Elam declares a dividend to its owner subsequent to the date of this Order, Elam shall file a written notification with the Commission within 10 days of the dividend declaration. The written notification shall include a cash flow analysis showing the impact of the declared dividend on the financial condition of Elam and an explanation of why the payment of dividends is reasonable.

Done at Frankfort, Kentucky, this 24th day of October, 2003.

By the Commission

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2003-00171 DATED October 24, 2003

	<u>Base Rate</u>	<u>Gas Cost Adjustment</u>	<u>Total</u>
<u>Residential/Commercial</u>			
Customer Charge	\$6.15		
All Mcf	\$4.2999	\$6.5249	\$10.8248
<u>Industrial</u>			
Customer Charge	\$9.00		
All Mcf	\$3.8101	\$6.5249	\$10.3350